



Boston Public Garden



**City of Boston
Auditing Department**

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December 17, 2004

*The Honorable Mayor and
Members of the City Council:*

We are pleased to submit to you the Comprehensive Annual Financial Report (CAFR) of the City of Boston (City) for the fiscal year ended June 30, 2004. The accuracy of the financial statements together with the completeness and fairness of their presentation are the responsibility of the City's management. This report is accurate in all material respects and all disclosures necessary have been included to fairly present the financial position of the City. The financial position and results of operations of the various funds have been prepared in accordance with generally accepted accounting principles (GAAP), as established by the Governmental Accounting Standards Board (GASB). All requirements of State finance law of the Commonwealth of Massachusetts and the City Charter have also been satisfied.

The City of Boston composes this Letter of Transmittal to provide additional information to the readers of the CAFR. The financial statements are presented utilizing a financial reporting model promulgated by GASB. This financial reporting model focuses on major funds, rather than fund types, and includes government-wide financial statements, which will include all revenues and all costs of providing services each year. These Basic Financial Statements report on all current assets and liabilities and also long-term assets and liabilities, such as capital assets, including infrastructure (roads and bridges). This narrative overview and analysis of the financial activities of the City is for the fiscal year ended June 30, 2004. Readers are further encouraged to consider this information in conjunction with the information that is supplied in the Management's Discussion & Analysis (MD&A) Section of the City's Basic Financial Statements.

This report is presented in three sections: (1) the Introductory Section includes general information about the City and summarizes financial activity for the fiscal year; (2) the Financial Section includes the Independent Auditors' Report on the City's Basic Financial Statements, MD&A, the Basic Financial Statements, the Combining and Individual Fund Financial Statements and Schedules for the various funds including required supplemental information; and (3) the Statistical Section includes financial data, debt computations, and a variety of demographic, economic and supplemental statistical information concerning the City.

In addition to the Basic Financial Statements of the City, this report includes information pertaining to component units included in the City's reporting entity because of the significance of their operational and/or financial relationship with the City as required by GASB Statement No. 14. The State-Boston Retirement System (SBRS) has been presented as a blended component unit because it provides services almost exclusively to the primary government.

Thomas M. Menino, Mayor
Sally D. Glora, City Auditor

Discretely presented component units are reported in a separate column to emphasize that they are legally separate from the City, but are included because the City is financially accountable for and is able to impose its will on the organizations. The following component units have been discretely presented in the Basic Financial Statements: Boston Public Health Commission, Boston Redevelopment Authority, the Trustees of the Public Library of the City of Boston, and the Economic Development Industrial Corporation.

Economic Conditions and Outlook

The City is the economic hub of both the Commonwealth of Massachusetts and the New England region. It is a center for professional, business, financial, higher education and medical services as well as transportation, communication, export, cultural and entertainment activities. Boston is also the state capital and the host to several federal agency offices. High technology, tourism, research and development, manufacturing, and wholesale distributions also contribute to the economy of the City and its suburbs. After a few years of sluggish and unenthusiastic growth beginning in spring of 2001, the City's economy has begun to grow again and, as of summer of 2004 to perform reasonably well.

The financial markets continue to express their confidence in Boston's fiscal health. The credit ratings: Moody's Aa2, and Fitch AA-, were reaffirmed in February 2004. Standard & Poor's upgraded Boston's credit rating from AA- to AA in conjunction with the City's \$143.2 million bond issue in February 2004. The credit reports of the three rating agencies stated that their ratings reflected the City's: 1) Strong management and demonstrated ability to make budget adjustments as necessary to maintain balance during difficult financial times; 2) Sound financial position with sufficient reserves; 3) Manageable debt burden with prudent debt policies; and 4) A stable, well diversified tax base that has doubled in value since 1996. These factors contribute to the confidence in Boston, along with Boston's dominant role in the New England economy.

Overview of Local Economy

In Spring 2001, Boston's nine-year economic expansion came to an end as an economic slowdown took hold. The number of jobs in the City reached an all-time high in the year 2000. Data from 2001 through year-end 2003 revealed employment losses. Although unemployment has risen since early 2001, the City's rate remains slightly lower than the nation's average as of June 2004. Boston's diverse economy is made up of financial and business services, research and development, health care and higher education, tourism and retail trade. Boston's housing market remained strong in 2002 and 2003 primarily because of low interest rates. The construction, manufacturing, communications, professional and business services, and finance segments of the economy have shown slowing tendencies in the past few years, while higher education and health care have continued to realize growth.

Future Economic Outlook

Dating from the spring of 2001, signs of a slow but improving economy in metropolitan Boston and the City were evident in Spring 2004, however the turnarounds for the U.S. and Massachusetts economies began in late 2003 and early 2004. Evidence of a turnaround, however, began showing up in the U. S. and Massachusetts in late 2003 and early 2004. The Boston economy peaked in the 1999-2000 time period as Boston's office, hotel and housing markets were among the strongest in the nation by mid-year 2000 and into early 2001. From about January of 2001 signs of economic slowing have been notable and have persisted through November of 2003. Boston's slowing economic growth in 2001 was clear given existing information, including: an increasing unemployment rate, a growing number of initial unemployment claims, a higher level of continuing unemployment claims, a falling hotel occupancy rate and lower average daily hotel room rate, a growing office vacancy rate, and a slowing in residential sales. These trends had persisted into 2003, except for residential sales, which have increased. The latest data, however, are showing improvement in the labor market as well, as the economy begins to grow. Initial and continuing unemployment claims have fallen and the unemployment rate has stabilized and is beginning to decline as shown by data from the State, the Boston metropolitan area and the City of Boston

Financial Overview

The Reporting Entity and Its Services

The City of Boston, incorporated as a town in 1630 and as a City in 1822, now exists under Chapter 486 of the Acts of 1909 and Chapter 452 of the Acts of 1948 of the Commonwealth of Massachusetts, which, as amended, constitute the City's Charter. The Mayor is elected to a four-year term and serves as chief executive officer of the City. The Mayor has general supervision of and control over the City's boards, commissions, officers and departments. The legislative body of the City is the City Council, which consists of thirteen elected members serving two-year terms.

Thomas M. Menino, Mayor of the City of Boston, was re-elected in November 2001 to a third four-year term, expiring in January 2006. The Mayor remains committed to promoting his initiatives in the areas of public education, public safety, housing and neighborhood development as well as economic development. The City provides a wide range of governmental services in these areas as well as in the areas of social services, public health, transportation, human services, and basic city services among others.

The governmental activities, business-type activities, the aggregate discretely presented component units and aggregate remaining fund information included in this CAFR are those for which the City is accountable, based on criteria for defining the financial reporting entity prescribed by the GASB. The criteria include legal standing, fiscal dependency and financial accountability. Based on these criteria the governmental activities, business-type activities, the aggregate discretely presented component units and aggregate remaining fund information shown

in this report are considered as part of the reporting entity (see Notes 1 and 2 of the Basic Financial Statements).

General Government Results

The City's financial position as shown in its Governmental Funds Balance Sheet as of June 30, 2004 includes overall fund balances of \$832.2 million represented by liabilities of \$292.4 million and by assets available to liquidate such liabilities of \$1.12 billion.

An operating surplus of \$81.9 million is reported in the General Fund for fiscal year 2004. As a result, the General Fund now has an accumulated surplus of \$573.2 million. The City completed its fiscal year ended June 30, 2004 with a combined Governmental Funds operating surplus of \$130.7 million as compared to a combined Governmental Funds operating surplus in the proceeding fiscal year of \$60.2 million. The Governmental Funds 2004 operating surplus of \$130.7 million includes a surplus of \$81.9 million in the General Fund, a surplus of \$47.4 million in the Special Revenue Fund, a surplus of \$3.0 million in Other Governmental Funds, and a deficit in the Capital Project Fund of \$1.5 million.

Cash Management

The City's Collector-Treasurer establishes the investment policies of the City. Portions of Massachusetts General Laws (M.G.L.) Chapter 29 and 41 govern these policies. Generally, the City's investment policy centers on receiving a competitive yield for its investible cash while ensuring safety. The balances held in the City's General Fund for investment are ultimately used to meet liability obligations and, therefore, are not available for what would be considered long-term investing. The duration of time during which funds are available for investment does vary; therefore, the City must carefully select the investment type most suitable for the given time frame to optimize income while maintaining safety and sufficient liquidity requirements. The City requires that repurchase agreements, certificates of deposits and sweep vehicles will be collateralized.

Additionally, the Collector-Treasurer working in tandem with the trustee(s) of the various trust funds has developed a detailed Investment Guidelines and Policy Statement for an Individual or Common Fund. M.G.L. Chapter 203 (Uniform Common Trust Act) provides that the City of Boston may establish common trust funds. The pooling of individual trust funds into a Common Trust allows for greater diversification of investment in asset classes, as well as reduced management cost.

Risk Management

The Risk Management Program focuses on a planned strategy of self-insurance supported by strong prevention and cost reduction efforts, financial reserves and catastrophic insurance. The

City is self-insured in most areas of risk including general liability, property and casualty, workers' compensation, certain employee health care costs, and unemployment compensation.

The City's legal liabilities are capped per M.G.L. Chapter 258, and Corporation Counsel defends the City in any lawsuits that arise from the normal course of operations. For workers' compensation, the City is exempt from state insurance requirements per M.G.L. Chapter 152 §25B. The City's Workers' Compensation Division, and Police and Fire Departments manage employee injury claims internally. The City budgets and funds for legal claims and employee injury costs through the General Fund, charging specific departments for their share of costs in order to promote awareness and prevention efforts.

The City purchases health insurance coverage for employees and retirees through a number of health maintenance organizations (HMO's), in addition to also offering several self-insured indemnity plans, which are administered by Blue Cross and Blue Shield of Massachusetts (BC/BS). HMO costs are funded through the General Fund, and the self-insured plans are financially managed through a trust fund established in compliance with section 3A of Chapter 32B of the M.G.L.

For unexpected large losses, the City has been continually building a catastrophic risk reserve, which has an available balance of \$7.1 million at the end of fiscal 2004.

To further protect the City's assets and finances from adverse loss, commercial insurance is purchased strategically for certain exposures. A catastrophic property insurance policy provides \$50.0 million all risk protection after \$20.0 million retention. Boiler and machinery losses are insured up to \$2.5 million per incident, after a \$50,000 deductible. Any losses related to the City's school buses are insured through the management contractor.

Capital Assets

The Capital Assets of the City are those capital assets used in the performance of governmental functions. They are reported in the Statement of Net Assets. At June 30, 2004, the capital assets of the City amounted to \$979.7 million. This amount represents the valuation of capital assets in accordance with GAAP and the City's capitalization policy as described in Note 2, "Summary of Significant Accounting Policies."

Fiduciary Operations

The City participates in a contributory defined benefit retirement system, the SBRS. The City is the largest member of the State-Boston Retirement System (SBRS), a cost sharing multiple employer public employee system operated under Chapter 32 of the M.G.L. All retirement allowances are paid from a fund supported by employee, employer and state contributions. Each participating employer's share of the total annual funding contribution is determined on the basis of active payroll.

The City is committed to funding based upon a schedule approved by the SBRs and the State actuary, which includes paying the current year's estimated present value of benefits earned during the year (normal cost) and an annual contribution toward reducing the unfunded liability to zero no later than the year 2028. The schedule is subject to update and approval at least every three years by the Public Employee Retirement Administration Commission (PERAC), a State agency established to oversee all 104 local Massachusetts public retirement systems. The annual appropriation, based on the approved funding schedule, is a legal obligation of the City that must be included as part of the tax rate certification by the Commonwealth of Massachusetts.

Beginning January 1, 2000, accumulated assets have been reported using the "asset smoothing" valuation method. Asset smoothing gradually incorporates over time annual investment gains and losses to determine actuarial value of assets used in determining a funding schedule, thereby avoiding the direct and immediate impact of dramatic upswings and downswings inherent in the equity markets.

The SBRs Board on an annual basis considers cost of living adjustments. As part of the annual review process, the Board considers the fiscal conditions of the City and whether the granting of the COLA would substantially impair the City's funding schedule. Cost of living adjustments are set each year at the CPI, or an amount up to but not greater than, 3% on the first \$12,000 of a retiree's annual payment. The Board approved a 3% COLA for 2004.

The City also operates the Boston Retirement System (BRS). BRS is the predecessor to SBRs and is closed to new members and is funded on a pay-as-you-go basis. The operations of BRS are not material to the City as a whole.

Accounting System and Budgetary Control

The accounts of the City are organized on the fund basis. Each fund is considered to be a separate accounting entity. The operations of each fund are accounted for by providing a separate set of self-balancing accounts, which comprise each fund's assets, liabilities, fund balance, revenues and expenses. An integrated computerized financial accounting system is maintained by the Auditing Department to record transactions within these accounts. This system is an encumbrance accounting system, which monitors the City's purchase orders for goods, services and other contractual commitments. The City budgets and maintains its books and records on a statutory basis of accounting prescribed by the Commonwealth of Massachusetts. This basis of accounting differs from accounting principles generally accepted in the United States of America.

The City's management is responsible for establishing and maintaining internal accounting controls designed to provide reasonable, but not absolute, assurance that the assets of the City are safeguarded from loss, theft or misuse. In addition, the internal control structure reasonably assures that adequate accounting data are compiled to allow for the preparation of financial statements in conformity with generally accepted accounting principles accepted in the

United States of America. The concept of reasonable assurance recognizes that: (1) the cost of a control should not exceed the benefits likely to be derived; and (2) the evaluation of costs and benefits requires estimates and judgments by management. The City Auditor is responsible for evaluating the adequacy and effectiveness of the control structure and the Auditing Department conducts a periodic evaluation of the control structure's effectiveness.

As a part of its internal control structure, the City maintains budgetary controls. The objective of these controls is to ensure compliance with the legally mandated budget adopted by the City Council. Activities of the General Fund are included in the annual budget. The budget within the Special Revenue Fund is established based on specific grant requirements or specific legislation, but is not subject to City Council approval. The Capital budget reflects long-term needs financed primarily through the issuance of bonds. This multiyear plan is subject to approval by the City Council. Specific budgets are established for each capital project prior to its inception.

The function and activity within the individual fund establishes the level of budgetary control. Budgetary control in this context defines the level at which expenditures cannot legally exceed the appropriated amount. In the case of the General Fund, this control is at the department level. In the case of the Special Revenue and Capital Projects Fund, the control is at the grant or project levels respectively. All of these budgetary controls reside within the City's financial system and are monitored by the Office of Budget Management and the Auditing Department to ensure compliance.

The Auditing Department initiates a fiscal year closing process that limits and controls departmental appropriation reserves through encumbrances and closely monitors the amount of prior year reserves carried forward. The process allows for the year-end closing and accompanying financial statements to be completed in an efficient and timely manner.

The Federal Single Audit Act requires the City to have an annual independent audit conducted on the federal financial assistance it has received. This audit is conducted simultaneously with the City's annual financial statement audit.

A significant portion of the Single Audit work is devoted to evaluating the City's internal control structure. The evaluation includes tests of a significant number of individual federal grant transactions that occurred during the fiscal year. The Single Audit work also requires that the auditors determine whether the organization has complied with laws and regulations that may have a material effect on each of its major federal financial assistance programs. All of the City's major federal programs are evaluated for the adequacy of internal controls and compliance with laws and regulations.

The City's Single Audit report for the year ending June 30, 2004 included no instances of material weaknesses in the internal control structure, nor was any significant violations of the applicable laws and regulations reported. The report is publicly issued under a separate cover. In addition to the annual audit of the federal financial assistance programs, the City also identifies

specific grants received from the State for compliance and internal control review by the independent auditors.

Other Information

Independent Audit

The Commonwealth of Massachusetts, through Chapter 190 of the Acts of 1982, requires that the City undergo an annual audit performed by a firm of independent public accountants. The City has selected the firm of KPMG LLP to perform the June 30, 2004 audit. This audit is conducted in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards*, issued by the Comptroller General of the United States. The audit provides an independent review to help assure a fair presentation of the City's financial position and results of operations.

The City also undergoes an annual audit of its Federal grant funds as required by the Single Audit Act. KPMG LLP issues separate reports on the City's internal control systems and compliance with applicable laws and regulations that meet the requirements of the Single Audit Act and Office of Management and Budget Circular A-133.

Awards

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the City of Boston for its comprehensive annual financial report (CAFR) for the fiscal year ended June 30, 2003. This was the ninth consecutive year that the City of Boston has received this prestigious award. In order to be awarded a Certificate of Achievement, a governmental unit must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of only one year. We believe that our current report continues to meet the Certificate of Achievement program requirements, and we are submitting it to the GFOA to determine its eligibility for another certificate.

In addition, the City of Boston also received the GFOA's Award for Distinguished Budget Presentation for its Annual Budget document for the fiscal year beginning July 1, 2003. The City of Boston's budget document was judged to be proficient in several categories including policy documentation and financial planning.

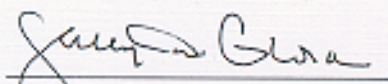
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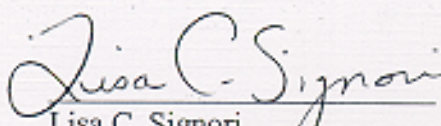
Acknowledgements

We would like to express our appreciation to the staff of the Accounting and Financial Reporting Program and all the members of the Auditing Department staff whose professionalism and dedication made the timely preparation of the CAFR possible. We also wish to thank the professional staff of KPMG LLP for their counsel, technical assistance and encouragement in the preparation of this CAFR. Several other City departments and agencies provided additional information and assisted in the CAFR preparation. We gratefully acknowledge their efforts and contributions to this report. Finally, we wish to thank you for your continued interest in the financial operations of the City, and for the planning and support necessary to conduct the City's financial operations in a responsible manner.

The City's Auditing and Management Information Services ("MIS") departments have worked to produce the City's annual financial statements on-line. The Basic Financial Statements and the Comprehensive Annual Financial Report ("CAFR") for FY02, FY03 and FY04 are featured on the City's web page (www.ci.boston.ma.us/auditing). On line access to these reports offers easy timely access to information and reduces costs.

Respectfully submitted,


Sally D. Glora
City Auditor


Lisa C. Signori
Chief Financial Officer and
Collector-Treasurer

Certificate of Achievement for Excellence in Financial Reporting

Presented to

City of Boston,
Massachusetts

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2003

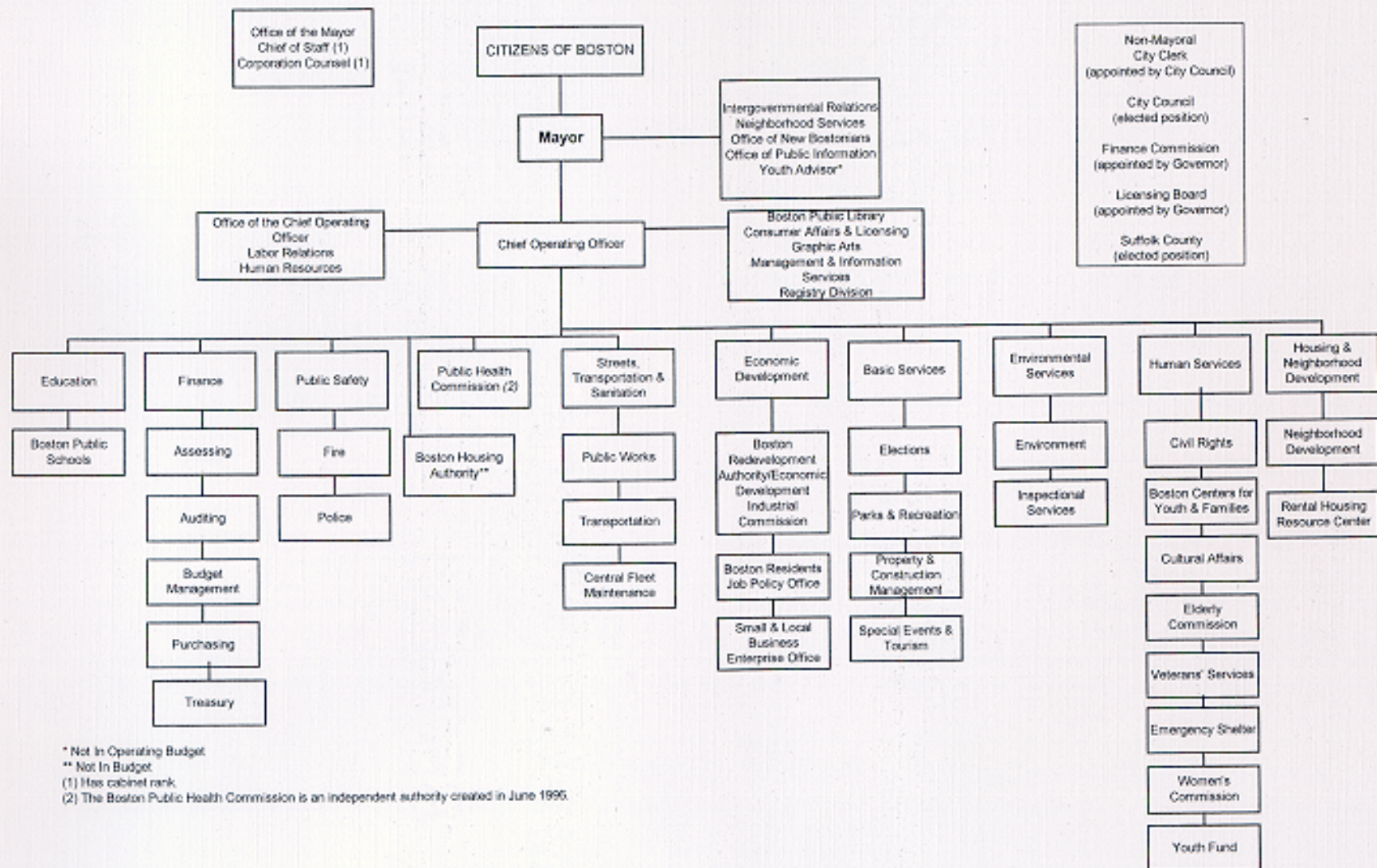
A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



President

Executive Director

ORGANIZATION OF CITY GOVERNMENT



ELECTED and APPOINTED OFFICIALS

Mayor

THOMAS M. MENINO

City Council Members

Michael F. Flaherty, Jr.(President)	At-Large
Maura A. Hennigan	At-Large
Stephen J. Murphy	At-Large
Felix D. Arroyo.....	At-Large
Paul J. Scapicchio	District 1
James M. Kelly	District 2
Maureen E. Feeney	District 3
Charles C. Yancey	District 4
Robert J. Consalvo	District 5
John M. Tobin	District 6
Chuck Turner	District 7
Michael P. Ross	District 8
Jerome P. McDermott	District 9

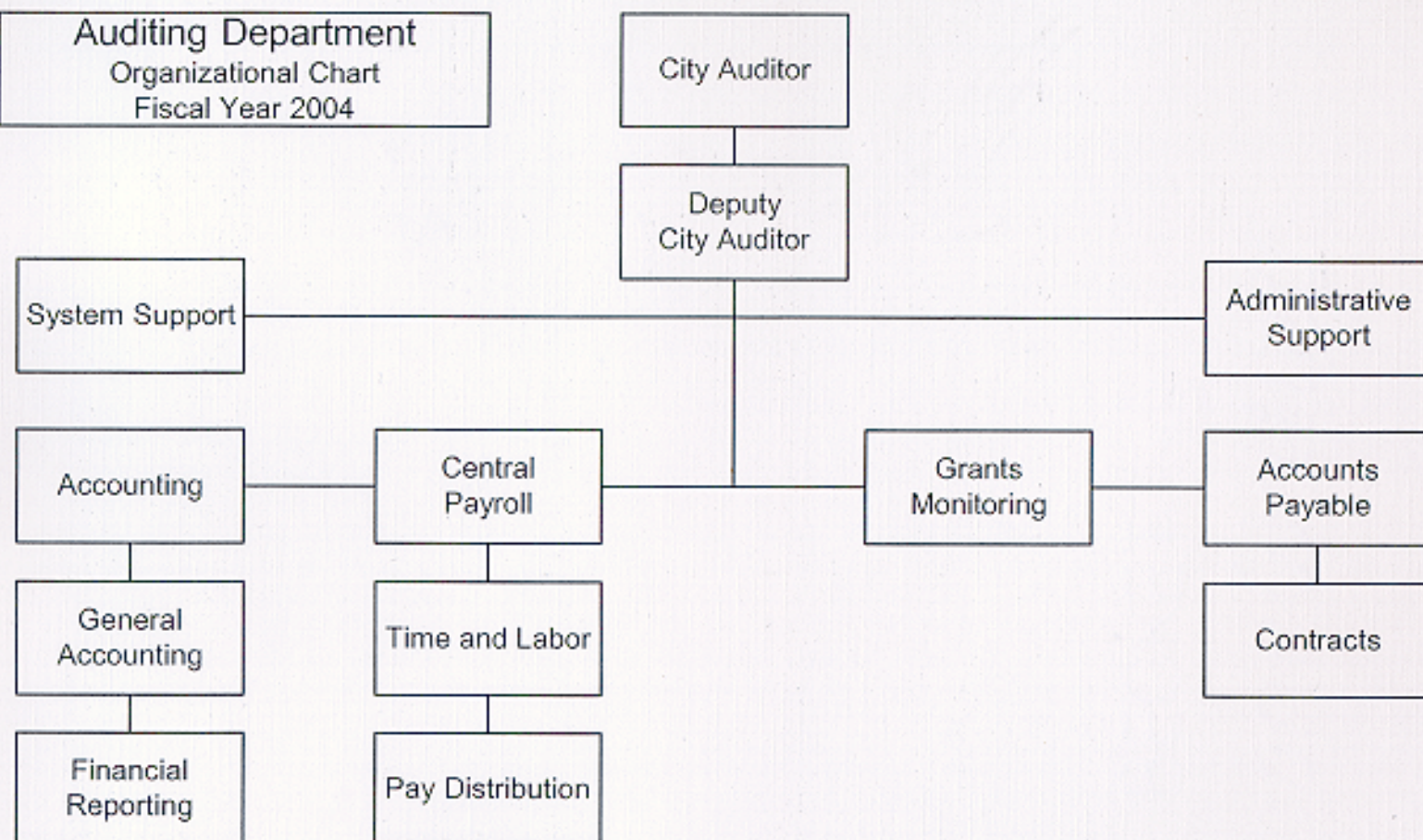
Suffolk County Officials

Andrea Cabral	Sheriff
Daniel F. Conley	District Attorney

Appointed City Executive Branch Members

William Holland.....	Director of Public Agency Relations
Dennis A. DiMarzio.....	Chief Operating Officer
Lisa C. Signori.....	Chief Financial Officer and Collector-Treasurer
Mark Maloney.....	Chief Economic Development Officer
Thomas W. Payzant.....	Chief of Education
Robert Lewis, Jr.....	Chief of Human Services
Michael Galvin.....	Chief of Basic Services
Andrea d'Amato.....	Chief of Environmental Services
Sandra B. Henriquez.....	Chief of Public Housing
Charlotte Golar-Richie.....	Chief of Housing
Kathleen O'Toole.....	Chief of Public Safety (Police Department)
Paul A. Christian.....	Chief of Public Safety (Fire Department)
Merita A. Hopkins.....	Corporation Counsel
John M. Auerbach.....	Chief of Public Health

Auditing Department
Organizational Chart
Fiscal Year 2004



Auditing Department Personnel

Sally D. Glora, City Auditor

Dennis J. Coughlin, Deputy City Auditor

Allan M. Brodsky

Domenica Cabral

Elvira Carnazzo

Michelle E. Castillo

Mattie Crouse

Christine Dennehy

Allen Hurley

Cynthia Johnson

Robert Kollar

Linda Lockhart

Nelly Lopez

Medina Lucien

Luis Carlos Martinez

Mary Ann Mason

Sheila A. McGonagle

Antonio Nunes

Diane O'Malley

Christine M. Opila

Michelle Pacitta

Charles T. Panagopoulos

Mary L. Raysor

Carol Rhodey

Magnolia Rojas

Desiree Russo

Christopher Sargeant

Lori Schilling

Lisa Stone

Ming C. Su

Donna Seel

Julie A. Tippet

Stanley J. Wallace

Paul F. Waple